THE WALL STREET JOURNAL.

https://www.wsj.com/articles/new-hotel-or-affordable-housing-race-is-on-to-define-opportunity-zones-1531474200

U.S.

New Hotel or Affordable Housing? Race Is On to Define 'Opportunity Zones'

Early projects likely to shape direction of program that gives tax breaks in low-income neighborhoods

Bridge Housing is working on a $500 million 'opportunity zone' fund to finance affordable housing, such as this project in the Watts neighborhood of Los Angeles, shown here in a photo courtesy of the nonprofit. PHOTO: STEVE PROEHL

By Ruth Simon and Richard Rubin

July 13, 2018 5:30 a.m. ET

A new Marriott hotel in the Phoenix area might seem a world apart from an affordable-housing complex in the Watts neighborhood of Los Angeles.

But both are poised to benefit from the new "opportunity zone" program created in last year's federal tax overhaul, which gives tax breaks for investments in low-income neighborhoods.

Real-estate developers, wealthy investors, nonprofit groups and local officials are among those racing to put their mark on the program, which has few restrictions. The first ventures are likely to shape the direction the program takes and whether it has lasting political support.

Some investors are focused on reaping tax benefits from projects like the Phoenix area hotel. Other ventures, like the one under way in Watts, aim to use the tax break to provide housing and other benefits to residents of struggling communities.

"This is the biggest initiative of this type by the federal government with the least debate, the least staff support, the least research and still the least clarity," said Eric Garcetti, the mayor of Los Angeles, who has been working on his own city's zones and assisting governments in Louisville, Ky., Oklahoma City and South Bend, Ind. "It hasn't really been fleshed out and that's exciting for me."

Unlike earlier federal efforts to spur economic development in poorer communities, the program takes a free-market approach and isn't backed with federal spending. Being designated an "opportunity zone" doesn't guarantee that a community will receive money for schools, health care or other services. Instead, private investors will decide whether to invest in designated areas and how to use those funds.

City and state officials are trying to determine how to attract funding and use their zoning rules, incentives and other tools to guide where and how money is spent. "There is going to be a lot of creativity," said Louisville Mayor Greg Fischer, who heads a U.S. Conference of Mayors committee studying how cities can tap the new program.

Foundations are exploring how they can foster investments that create jobs or services needed by low-income communities and ensure that existing residents benefit without getting displaced.

"One of the concerns we have is that opportunity zone capital will most naturally flow to projects that have the highest return with the least amount of risk," said Kimberlee Cornett, a managing director at the Kresge Foundation. "Investments most needed by these communities don't necessarily have those characteristics."

The opportunity-zone program is open-ended by design, said Sen. Tim Scott (R., S.C.), one of its authors, who drew on his experience growing up in a struggling area. "To transform a community, to have a paradigm-shifting experience, at least for me, came from the private sector," he said.

Under the new law, governors designated up to 25% of qualifying low-income census tracts as opportunity zones. To claim tax benefits, investors must put capital gains into special funds, which must keep at least 90% of their investments in stock, partnership interests or business property in these qualifying areas. Investors get additional benefits for holding investments longer.

The Treasury Department hasn't yet issued guidelines on how the program will operate and what rules investment funds must follow, but firms and investors are already positioning themselves to use the new benefit.

Bridge Housing, a nonprofit, is working on a $500 million opportunity zone fund to finance affordable housing in West Coast markets, such as the Watts neighborhood. The development includes housing and a community center with a swimming pool and offices for college-prep and job-training programs.

Virtua Partners, a Phoenix-based private-equity firm, is raising $200 million for an opportunity zone fund including three Phoenix-area projects: a 130-room Marriott hotel with furnishings by West Elm; 81 single-family townhomes with a swimming pool and clubhouse; and a 90-unit apartment complex near Arizona State University's campus in Tempe.

All three projects would have been completed even without the tax break, said Virtua executive Derek Uldricks, who said the opportunity zone program will speed fundraising.

The program is expected to cost the government $7.7 billion between 2018 and 2022, and $1.6 billion over 10 years as deferred taxes are paid, according to the Joint Committee on Taxation.

There is no limit on the potential tax benefits for investors and, unless the Trump administration decides otherwise, no requirement for measuring the program's effectiveness, such as examining which investments in each area use the new incentive.

The tax break is an easier fit for investing in real estate rather than in companies, some venture capitalists say. The legislation "was written by and for real-estate investors," said Ross Baird, president of Village Capital Group, a Washington, D.C.-based venture capital firm exploring other ways to use the program.

Factory OS Inc., based in the San Francisco area, is one of the few manufacturers to express much interest so far. The builder of modular homes hopes to raise roughly $20 million to buy sophisticated tooling for its factory, which opened last year. "With less expensive capital, we can grow faster than we might otherwise," said Rick Holliday, chief executive of the 75-person company.

Write to Ruth Simon at ruth.simon@wsj.com and Richard Rubin at richard.rubin@wsj.com